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No. 92-1384

IN THE
Supreme Court of the United States

OCTOBER TERM, 1992

BARCLAYS BANK PLC,
Petitioner,
v.

FRANCHISE TAX BOARD,
Respondent.

On Petition for Writ of Certiorari to the Supreme Court of California

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a non-profit association, which was originally organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST, which was separately incor-

porated January 1, 1992, has a membership of over 380 major multistate corporations, engaged in interstate and international business. COST's objective is to preserve and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

Virtually all COST member companies are engaged in business in the State of California, either directly or through subsidiary operations, and are subject to that State's corporate income tax. COST's membership includes a substantial number of corporations that are owned by non-U.S. corporations. A significant number of COST member corporations are engaged in business in jurisdictions outside the United States and would be subject to retaliatory actions by such jurisdictions should worldwide combined reporting be upheld. Therefore, COST has an interest in the instant case, in which the constitutionality of California's imposition of worldwide reporting on foreign parent unitary groups is at issue.[1]

SUMMARY OF ARGUMENT

The State of California's imposition of worldwide combined reporting has been the subject of Foreign Commerce Clause challenges for over twenty years. Although this reporting method, as applied to domestic parent groups, was upheld in *Container Corporation of America v. Franchise Tax Board*, 463 U.S. 159 (1983), this Court explicitly reserved the specific question at issue in this case, that is, whether worldwide combined reporting as imposed on a foreign parent unitary group violates the Foreign Commerce Clause. *Id.*, 463 U.S. at 189, fn. 26.

[1] Worldwide combined reporting, the method used by California to apportion the income of multinational corporations, and the arm's length/separate accounting method, which is used by the United States and its foreign trading partners to allocate such income, are explained by petitioner in its Petition for Writ of Certiorari, at pages 5-6.

Not only does this case raise the issue reserved by this Court in *Container*, but it also presents certain facts that the Court emphasized as missing in *Container*, thereby precluding a finding for the taxpayer in that case. Unlike *Container*, the tax at issue in the instant case falls on a foreign entity, 463 U.S. at 195, the Federal Government has filed *amicus* briefs during the litigation in the California courts expressing its opposition to worldwide combined reporting, 463 U.S. at 195-196, and this Court no longer has to guess at the risk of retaliation by foreign nations, 463 U.S. at 194, as the offense to our foreign trading partners has been clearly expressed by the United Kingdom's enactment of retaliatory legislation. Thus, ten years after *Container*, this Court is finally presented with a fully developed opportunity to answer the important constitutional issue left open in that case.

As California's Franchise Tax Board pointed out in its Petition for Review and Brief on the Merits in the California Supreme Court, *Barclays* is the "test case" with regard to foreign parent unitary groups. Petition at 2, n. 1; Brief at 5, n. 6. This case affects not only Barclays, but also the large number of other taxpayers waiting for a final determination by this Court on the issue of whether worldwide combined reporting as imposed on foreign parent unitary groups violates the Foreign Commerce Clause.[2]

Moreover, the decision of the California Supreme Court, holding that "governmental silence" evidences Federal approval of worldwide combined reporting (or any other state policy implicating foreign relations) sets a precedent that is contrary to this Court's Foreign Commerce Clause

[2] The number of affected taxpayers is so large that the Franchise Tax Board was compelled to issue FTB Notice 89-714 on November 17, 1989, outlining the procedure to be used by taxpayers to defer cases pending a decision of the Foreign Commerce Clause issue in *Barclays*. Pet. App. I.

jurisprudence as developed in *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434 (1979), *Container, supra, Wardair Canada v. Florida Department of Revenue,* 477 U.S. 1 (1986), and most recently affirmed in *Itel Containers International Corp v. Huddleston,* 61 U.S.L.W. 4173 (Feb. 23, 1993).

Because of the implications of the decision of the California Supreme Court for the Federal Government's ability to conduct foreign policy; the importance of the issue to the states and to a large number of taxpayers, as well as foreign governments; and the number of years this issue has been pending in litigation, this Court should grant the petitioner's petition for writ of certiorari.

ARGUMENT

I. CERTIORARI SHOULD BE GRANTED IN THIS CASE BECAUSE THE FEDERAL GOVERNMENT'S ABILITY TO FORMULATE FOREIGN TRADE POLICY IS IMPAIRED BY CALIFORNIA'S IMPOSITION OF WORLDWIDE COMBINED REPORTING ON FOREIGN PARENT UNITARY GROUPS

Article I, § 8, cl. 3 of the United States Constitution reserves to Congress the power to regulate commerce with foreign nations and among the states. This Clause, "by its own force created an area of trade free from interference by the States" and "even without implementing legislation by Congress is a limitation upon the power of the States." *Boston Stock Exchange v. State of Tax Commission,* 429 U.S. 318, 328 (1977). With regard to foreign commerce, the "constitutional prohibition against state taxation . . . is broader than the protection afforded to interstate commerce . . . because matters of concern to the entire Nation are implicated." *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance,* 112 S. Ct. 2365, 2370 (1992). Because foreign commerce is afforded broader protection, this Court stated in *Japan Line, Ltd. v. County of Los Angeles,* 441 U.S. 434, 448 (1979), that "[f]oreign commerce is preeminently a matter of national concern" and held that a state tax violates the Foreign Commerce Clause if it "impair[s] federal uniformity in an area where federal uniformity is essential."

Last month in *Itel Containers International Corp v. Huddleston,* 61 U.S.L.W. 4173 (Feb. 23, 1993), this Court reaffirmed that when a state tax is being scrutinized under the Foreign Commerce Clause, the tax must be analyzed under the tests set forth in *Japan Line,* as well as the four-prong test set forth in *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977).[3] Quoting *Japan Line, supra* at 451, this Court stated in *Itel, supra* at 4176, that

> a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and second, whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments."

In *Container Corporation of America v. Franchise Tax Board,* 463 U.S. 159 (1983), this Court elaborated on the "one voice" requirement of *Japan Line,* stating that where a state tax is at variance with federal policy, the "one voice" standard is violated if the state tax "*either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." 463 U.S. at 194 (emphasis in original). In determining

[3] In *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279 (1977), this Court set forth the following four-prong test for determining whether a state tax comports with the interstate commerce clause: 1) whether there is a substantial nexus between the state and the activity it seeks to tax; 2) whether the tax is fairly apportioned to the taxing state; 3) whether the tax discriminates against interstate commerce; and 4) whether the tax is fairly related to the services provided by the state.

whether the "one voice" test is violated due to the implication of foreign policy, this Court stated that "[t]he most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Id.*

In *Container*, this Court felt that it could not determine when a foreign nation might be offended by a state tax policy. However, it is now indisputable that foreign trading partners are offended by worldwide combined reporting and that retaliatory actions with national impact may be taken. In 1985, the United Kingdom enacted retaliatory legislation that would deny certain tax credits, provided by the United States/United Kingdom Income Tax Treaty,[4] to United States corporations doing business in a state imposing worldwide combined reporting. Finance Act of 1985, section 54, recodified as Section 812 of the Income and Corporation Taxes Act of 1988. Although the United Kingdom has not yet triggered this provision, "[t]he risk of retaliation . . . under these circumstances, is acute." *Japan Line, supra,* 441 U.S. at 450.

The risk of offending a foreign trading partner and prompting retaliatory action is all the more acute in the face of the decision of the California Supreme Court upholding the constitutionality of worldwide combined reporting as imposed upon a unitary group whose parent is a United Kingdom corporation.[5] As this Court stated

[4] Under the United States/United Kingdom Income Tax Treaty, a United States corporation receives a refund of certain amounts of taxes withheld by a United Kingdom payor on dividends paid by that payor. United States corporations are entitled to this refund for taxes paid on dividends received from U.K. subsidiaries and from investments of at least 10% in unrelated U.K. corporations.

[5] In *Unitary Tax: Review of Progress Towards Resolving the Problems*, a Joint Report by Inland Revenue and the U.S. Treasury, issued in December, 1991, the United Kingdom reviewers concluded

in *Japan Line*, "California, by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." 441 U.S. at 453.

Moreover, the retalitory action taken by the United Kingdom "of necessity would be felt by the Nation as a whole," *Japan Line, id.*, because the impact of its retaliatory statute is not limited to California based corporations. The statute denies the refund otherwise due a United States corporation under treaty if the U.S. corporation or one of its affiliates has a "qualifying presence" in California. Income and Corporations Taxes Act of 1988 ("1988 Act"), section 812(1). The United Kingdom may, at its discretion, consider a company to have such a "qualifying presence" within California if it is subject to tax by the State, 1988 Act, section 812 (7), or if the corporation has relatively small property, payroll or sales in California. 1988 Act, section 812(3). Therefore, a corporation doing business in every state except California and which receives dividends from investments in U.K. corporations could face a greatly increased U.K. tax burden if it is simply affiliated with a corporation with minimal contacts with California.

California's deviation from the internationally accepted allocation method also imposes enormous accounting and administrative burdens on taxpayers with affiliates in both California and foreign countries. Since the foreign corporations that are required to be included in a worldwide unitary group are not taxable in the United States and may not have any transactions with any U.S. entity, they have no reason to maintain books and records on a U.S.

that, *pending settlement of the issue of the constitutionality of worldwide combined reporting through litigation*, the United Kingdom "should maintain its retailatory legislation on the statute book, giving no further guarantees as to whether the legislation, if it were to be triggered, would be retrospective, but should not trigger it." ¶ 7.2.a.

basis or on a basis reflecting the State's three-factor (property, payroll and sales) formula. Thus, the use of the worldwide combined reporting system requires a totally separate record keeping system solely for California tax purposes.

The worldwide combined reporting method requires a foreign corporation to prepare and maintain records in United States currency. The required conversion of financial data of each foreign subsidiary to United States dollars must take into account many different exchange rates and sharp fluctuations of value. Such computations are a costly and burdensome administrative expense necessitated by California's deviation from international and federal tax standards. The costs of complying with the administrative requirements of California's tax system may, in fact, exceed any tax which is ultimately due the state.

The administrative compliance burden of worldwide combined reporting in the face of an otherwise uniform standard is prohibitive and creates the very barrier to international trade that the foreign commerce clause is intended to prevent. It also presents a formidable barrier to interstate commerce when a foreign-owned entity doing business in a non-worldwide combined reporting state, *e.g.*, Illinois, starts to do business in California. That entity, if related to any foreign entities through a foreign parent, would subject each company in the entire group to onerous record keeping requirements solely to satisfy California's tax return filing requirements.

Taxpayers have challenged California's use of worldwide combination on Foreign Commerce Clause grounds since the State began enforcing this form of taxation. The instant case involves the 1977 tax year and was pending during the *Container* litigation. Thus, ten years after that case and sixteen years after the tax year at issue, the Court finally has the opportunity to answer the

quesion it left open in *Container*. The California Franchise Tax Board recognizes that *Barclays* is the test case, and, therefore, the best vehicle for this Court to decide whether the imposition of worldwide combined reporting on foreign parent unitary groups violates the Foreign Commerce Clause. Franchise Tax Board Petition to the California Supreme Court at 2, n.1 and Brief on the Merits at 5, n.6; *see also*, Franchise Tax Board Notice No. 89-714, Pet. App. I. This Foreign Commerce Clause issue is of such importance to international trade and the retaliatory threat to domestic corporations so immediate that it must not be left unanswered by this Court any longer.

II. CERTIORARI SHOULD BE GRANTED IN THIS CASE BECAUSE THE DECISION OF THE CALIFORNIA SUPREME COURT IS CONTRARY TO THIS COURT'S FOREIGN COMMERCE CLAUSE JURISPRUDENCE

According to the decision of the California Supreme Court, Congressional ratification of worldwide combined reporting is evidenced by the fact that Congress has not, either in a committee or in the full House or Senate, voted on legislation preventing such a state tax on foreign commerce.[6] Misinterpreting *Wardair Canada v. Florida De-*

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[6] The California Supreme Court did rely heavily on the Senate's actions in ultimately ratifying the United States-United Kingdom income tax treaty without a prohibition of States' use of worldwide combined reporting. However, this was not an action that was taken by the entire Congress. Only the Senate gives its consent to foreign treaties. U.S. Constitution Art. II, § 2. This action cannot be imputed to the House or used as evidence of *Congressional* approval of California's use of worldwide combined reporting. There is no authority to support the California Supreme Court's use of the failure of two-thirds of the Senate to ratify a treaty containing a specific provision, pursuant to its powers under Article II of the Constitution, as evidence of the intent of the majority of the Congress to approve a state tax affecting foreign commerce pursuant to its authority under Article I of the Constitution. In fact, a

partment of Revenue, 477 U.S. 1 (1986), the California Supreme Court concluded that there is a "species of governmental *silence* that forecloses resort to a dormant foreign commerce clause analysis." *Barclays Bank International, Ltd. v. Franchise Tax Board,* 899 P.2d 279, 291 (Cal. 1992) (emphasis in original). However, this Court held in *Wardair* that it is just such governmental silence that triggers the dormant commerce clause analysis. The dormant commerce clause analysis was not applied by the Court in *Wardair* because the federal government was not silent, but had affirmatively acted by entering into international agreements explicitly limiting certain local tax powers. *Wardair, supra* at 9-10.

The California Supreme Court's misapplication of *Wardair* could be used to justify any state action affecting foreign commerce where Congress has not acted, effectively destroying the protections to foreign trade provided by the dormant Commerce Clause. This broader issue, as well as the specific issue with regard to worldwide combined reporting, requires review and clarification by this Court.

majority of the Senate voted against a reservation deleting the provision prohibiting states from imposing worldwide combination. Joint Committee on Taxation, *State Taxation of Multinational Business* (JCX -27-86), September 29, 1986, p. 19.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

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